INVESTOR NEWS

Issue 9 July 2025

FINAL REPORT OF THE INDEPENDENT WATER COMMISSION

Hello and welcome to our Summer 2025 investor update.

The widely anticipated final report of the Independent Water Commission was published on 21 July and unsurprisingly is the focus of our summer bulletin. We've been through all 464 pages of the report and herein we give our initial take on the conclusions and 88 recommendations the Commission has put forward to government.

We see the review as significantly positive for the sector and for Severn Trent. The focus on longer term growth provides stability and security for investors, underpinned by a commitment to provide a fairer risk and returns package. It is also clear that outperformance incentives are here to stay, and the inflation-linked regulatory asset base is untouched - both good pieces of news for us.

We welcome the recommendation for the UK government to "reset its approach to strategic communications". In our view a shift in the sector rhetoric will only improve the attractiveness of the sector to investment.

The government will need to decide over the coming months which of these recommendations to take forward. Environment Secretary Steve Reed responded shortly after the publication in a speech welcoming the report as a key milestone in "establishing a new partnership" between water companies, investors, communities and the government.

The headline target which emerged from the speech was a government commitment to halve storm overflow spills within five years – which is already in line with our current spills commitment, a target that Severn Trent is well on track to achieve. In our latest Trading Statement, we shared that the first six months of 2025 had seen a 65% reduction in spills compared to the equivalent period in 2024, meaning we are well on track to deliver on our promise.

And of course, the report has reiterated that our AMP8 plans will continue uninterrupted. This means the next five years will deliver around 60% growth in our capital base, a reduction in our impact on rivers to below 2% of the Environment Agency's measure for Reasons for rivers Not Achieving Good ecological Status (RNAGS), and the achievement of operational net zero.

WE TAKE AWAY FOUR KEY MESSAGES FROM THE REPORT:

1. The case for long-term growth has been strengthened.
2. There is a commitment to providing a fair risk/return package for investors while retaining the opportunity to outperform.
3. Supervisory and regional framework introduced, allowing for company-specific approach and 'constrained discretion'.
4. Positive changes to regulatory framework for investors.

> "For investors, it will provide the clarity and direction required for a strong partnership between Government, the sector and investors to attract billions of pounds of new funding."
>
> **Steve Reed, Environment Secretary, 21 July 2025.**

Read more from Steve Reed in his article on CityAM, published 22 July 2025.

WONDERFUL ON TAP

SEVERN TRENT

1 THE CASE FOR LONG-TERM GROWTH HAS BEEN STRENGTHENED

Higher levels of investment will continue well into the future.

(paragraph 916).

The Commission's report has reiterated the need for continued significant investment over the long term, with proposed changes supporting greater visibility of growth, highlighting additional areas where investment is required, and advocating to simplify the delivery process.

The new vision states that Price Reviews should be funding check-in points in the context of a long-term plan (paragraph 154), with greater clarity given over the level and types of investment required in the future. In practice, the Commission envisions long-term objectives set by the government which informs systems planners, with each five year business plan achieving milestones on the way to those targets.

- **Page 88:** "Governments publish their National Water Strategy, setting out long-term objectives for the water sector with interim milestones."
- **Paragraph 242:** "A new long-term, legally binding target for the water environment should be established, to provide certainty and direction for future investment, and drive progress through delivery across all sectors."
- **Paragraph 100:** "The plans produced by the water industry in response to the objectives of the systems planner would form the basis of the Price Review."
- **Recommendation 4:** "Water industry investment planning should be conducted on a 5/10/25 year basis with the greater certainty and granularity for the first 5 years, more indicative plans for the following 5 years and higher level indication for the longer term."

The report also highlighted specific areas which may require further investment. This could unlock substantially more growth for our company over the next few decades. Some of the core areas identified for additional investment include:

1. Compulsory smart metering **(Recommendation 37)**
2. New national resilience standards **(Recommendation 66)**
3. New asset health standards **(paragraph 889)**
4. Increased flexibility for reopeners **(paragraph 159)**
5. Additional growth from new housing **(paragraph 915)**
6. Further investment in security **(Recommendation 70)**
7. Greater digitisation of monitoring **(Recommendation 25)**
8. Expanded water re-use programmes **(paragraph 588)**
9. Mechanism to update water quality standards **(paragraph 569)**

And finally, there are recommendations to make the process easier, including updating the planning process (Recommendation 73), reducing the number of elements which require planning permission (Recommendation 74), and supporting infrastructure projects to gain permits and consents (Recommendation 75).

2 THERE IS A COMMITMENT TO PROVIDING A FAIR RISK/RETURN PACKAGE FOR INVESTORS WHILE RETAINING THE OPPORTUNITY TO OUTPERFORM

One of the clear commitments from this review was the desire to provide a fairer risk and returns package, creating a more predictable and sustainable investment environment in order to attract long-term investors. The framework outlined in the report suggests an improvement to the base return while retaining the existing levers of outperformance.

On the base return, the review identified several limitations of the current framework, recognising investor concerns that the WACC "is significantly below those of comparable sectors" **(paragraph 405),** is unresponsive to market changes **(box 20)**, and is inconsistent with other similar sectors **(paragraph 406).**

The Commission suggests addressing these issues by "providing the CMA with responsibility to set a common WACC methodology for all UK regulated sectors" **(Recommendation 23),** including potentially updating relevant components of WACC annually, to reduce variation between different sectors and provide "more stability for investors" **(paragraph 498).**

Severn Trent have been clear sector leaders on returns over the last regulatory period, and we still expect to earn outperformance on top of the base return through a combination of financing, totex, performance incentives and our non-regulated business.

On financing, the landscape looks relatively unchanged following the review. The creation of a more stable environment, including possible annual reviews of the cost of capital, would give improved opportunity for lower costs of debt, while the added security following the conclusion of a once-in-a-generation review gives greater long-term certainty. We're still well positioned on financing with a low cost of embedded debt, and feel confident of performing strongly in the 5 years of the current regulatory regime.

The proposed changes to totex emphasise ensuring companies have sufficient allowances to maintain and enhance assets **(Recommendation 19).** Outperformance generated through efficiency was reiterated as a part of the proposed framework **(paragraph 460),** while any potentially higher allowances given to improve asset standards offers more scope to realise efficiencies.

Based on the recommendations in the report, Outcome Delivery Incentives (ODIs) are here to stay but with a simpler and "less aggressive" framework **(paragraph 477).** In practice, **Recommendation 22** suggests a slimmer set of around **10 ODIs that are common across the sector,** with targets that factor in company-specific context in order to limit downside risk. To avoid overlapping punishments, the remaining ODIs will be activities not otherwise captured by enforcement activities, and therefore we could potentially **expect measures such as leakage, supply interruptions, and sewer floodings to remain as ODIs** – areas in which we've performed strongly in recent years.

Given the historical sector underperformance on ODIs, a reduction in downside risk will help to restore trust and create a stronger sector, although as clear sector-leaders since the inception of ODIs, we will of course be lobbying to ensure sufficient incentives are in place to drive performance in the areas that customers care about.

Meanwhile, **Recommendation 78** outlines a revised and enhanced Performance Commitment Deliverable (PCD) framework, covering both enhancement spend and capital renewals **(paragraph 975),** monitored at a programme level and with increased flexibility. Given we are already targeting the maximum possible reward on PCDs for AMP8, we remain confident that we could continue to benefit from any future change or expansion to the PCD framework.

And we will be able to continue to earn enhanced returns through our non-regulated businesses.

ODIs ARE HERE TO STAY

AROUND 10 ODIs COMMON ACROSS THE SECTOR

A REVISED AND ENHANCED PCD FRAMEWORK

3 SUPERVISORY AND REGIONAL FRAMEWORK INTRODUCED, ALLOWING FOR COMPANY-SPECIFIC APPROACH AND ‘CONSTRAINED DISCRETION’

The media headlines on the day of the report revolved around the new regulator that will be created – this won’t happen overnight, and Ofwat will continue to manage during the transition period. We work well with all our regulators, and that will continue with the new regulator when it eventually arrives.

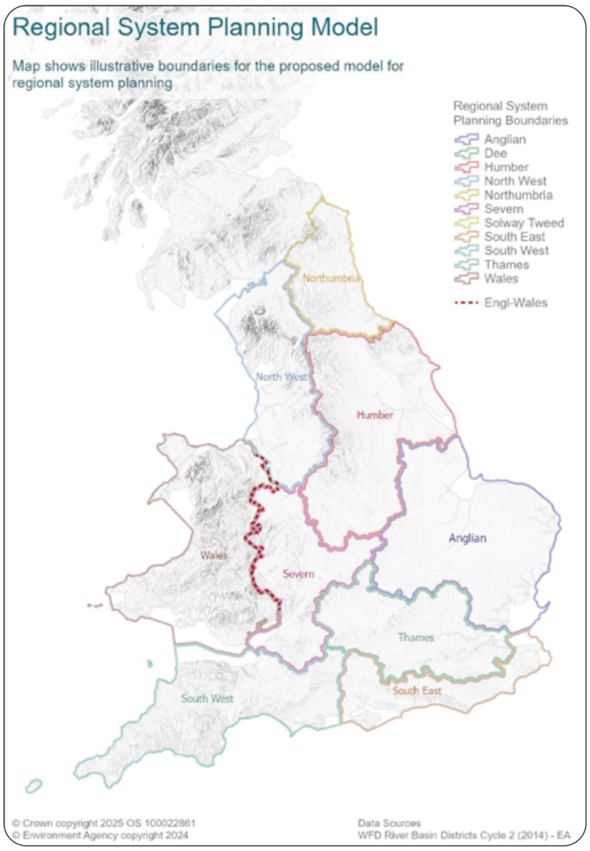
More broadly, the recommendation to move to a new regulator linked to two main regulatory shifts:
a move to a more supervisory approach and a greater regional voice in planning decisions.

We expect the supervisory function will lead to more engagement with the regulator so that we can explain our specific investment needs. It should be staffed with “high calibre engineering and financial expertise” **(paragraph 435),** and is likely to lead to more opportunities for company-specific business cases, which we have a proven track record of landing.

And the recommendations in the report suggest that the level of specific oversight is likely to flex based on the regulator’s “confidence in the company’s compliance and ability to deliver… reducing the need for extensive data requests, assessment, and validation in that process” **(Box 24).**

We also expect to adapt well to a more regional approach. Engaging with regional bodies covering our area isn’t that different to the current approach where we work with different local bodies, for instance local Environment Agency offices as part of our WINEP schemes, through which we fulfill our environmental obligations.

And it also aligns with our move to more county-based engagement over the last few years – we have great regional connections, including with mayors, MPs and councils who are keen for us to invest more, so the regional bodies should help unlock additional growth.



Proposed Regional Systems Planning Illustrative Boundaries, figure 5 of the Independent Water Commission final report.

4 POSITIVE CHANGES TO REGULATORY FRAMEWORK FOR INVESTORS

There are other positive changes to the regulatory framework included within the report that should bring more predictability for investors.

The Commission recommends that the UK and Welsh Government should include a target relating to the stability of the regulatory model as an objective in its strategic guidance **(Recommendation 52),** as part of a wider push to support the investibility of the sector.

For instance, the report advocates for improving sector governance standards, including bringing all companies in line with the UK Corporate Governance code **(Recommendation 50).** This wouldn't represent a change for Severn Trent, but would lift all companies in the sector up to the same level of governance and transparency. The report also suggests inserting a 'public benefit' clause into water company appointment licences **(Recommendation 49),** which Severn Trent has been an advocate of for some time.

As part of the efforts to rebuild trust in the sector, there is a recommendation for the government to "reset its approach to strategic communications" regarding the water industry **(Recommendation 53)** – outlining the progress made by water companies and introducing more balance by acknowledging other contributors to environmental outcomes in order to shift the media narrative and create a sense of resetting the sector.

The report also recommends changing the CMA process to bring it more in line with the standard appeals process of other sectors **(Recommendation 24),** allowing companies to appeal specific elements of a price review without resorting to a total redetermination.

We'll still be working to 5-year price control cycles **(Recommendation 4),** and the econometric modelling used to assess company business plans will remain, albeit balanced with equal weight of company-specific and expert supervisory judgement **(paragraph 422).**

As noted earlier, the report recommends standardising the methodology for calculating the WACC across regulated sectors **(Recommendation 23),** including potentially updating the WACC annually in response to market conditions **(paragraph 497),** in order to create greater consistency and reduce overall risk. More generally, as part of its efforts to improve investibility, the report signals a move away from using the 'notional company' approach to financeability – and as a company we have reported Return on Regulated Equity on an actual company basis in our most recent set of results.

There is additional focus placed on giving sufficient investment to improve asset health and fund ongoing maintenance, as seen in recommendations to reassess funding levels for asset renewals **(paragraph 889),** oversee statutory resilience standards **(Recommendation 66),** and ringfence funding for capital maintenance **(Recommendation 19).** The Commission also supports greater use of mechanisms like transition spend, which Severn Trent used significantly more than other companies in AMP7, to smooth out companies' capital profiles **(paragraph 156).** And it encourages water efficiency, such as through new tariff models which incentivise lower usage **(Recommendation 38).**

"There are other positive changes to the regulatory framework included within the report that should bring more predictability for investors."

WHAT DOES THE PROCESS LOOK LIKE FROM HERE?

TIMELINE

- Publication of the final Independent Water Commission Report – 21 July 2025
- Full UK government response and implementation plan – end of 2025
- Government legislation and reform anticipated by 2027
- Draft PR29 methodology – Q3 2027*
- Final PR29 methodology – Q4 2027*
- PR29 Business Plan submission – Q1 2029*
- PR29 Draft Determinations – Q2 2029*
- PR29 Final Determinations – Q4 2029*

* The final report suggests that to allow time for the recommendations to be implemented there could be "a short standalone price control cycle, to act as a bridge between Price Review 2029 and the next price control, which could for example begin in 2031/32 or to extend Price Review 2024" **(paragraph 1043).**

IN OTHER NEWS

- We released our latest **Trading Statement** earlier in July, which included an update on our year-to-date performance on storm overflow spills – our average spills performance for the first six months of 2025 was around five, leaving us well ahead of our annual ODI target of 18.

You can see the full detail from our Trading Statement by scanning the QR code.

- Earlier this week our Treasury Team successfully executed a 12 year sustainable bond, raising €700m with a peak order book of over €4.4bn. The bond was very tightly priced, around 75bps inside the iBoxx (after adjustment for the "halo" effect), and takes the total amount raised this calendar year to over £1.6bn.
- We've also been full steam ahead onboarding customers to our new Kraken customer management system. We've migrated around 85% of our customer base to the platform, meaning more than 3 million customers are now on Kraken as we look to complete our transition over the coming weeks.

KEY CONTACTS

Please get in touch with the team at: investorrelations@severntrent.co.uk – we'd love to hear your feedback or help with any queries you may have.

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